Nos. 13 and 15

IN THE

Supreme Court of the United States

OCTOBER TERM 1968

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et al.*,
Appellants

vs.

ABERDEEN AND ROCKFISH RAILROAD COMPANY, *et al.*,
Appellees.

INTERSTATE COMMERCE COMMISSION,
Appellant

vs.

ABERDEEN AND ROCKFISH RAILROAD COMPANY, *et al.*,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF LOUISIANA, NEW ORLEANS DIVISION

MOTION TO AFFIRM

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Hence, the Court rejected the suggestion that the advantages of the North were a justification for discrimination against the South, and it ordered that discrimination removed by putting into effect a uniform class rate structure. This was finally done in 1952, and for the first time in this century, the South enjoyed a position of equality with the North with respect to the cost of rail transportation.

Although the decision in *New York* v. *United States* had made it clear that the South was entitled to this position of equality, the Northern interests refused to accept equality with the South. Having failed to convince the Court that the North was entitled to lower rates because of "natural advantages," these interests decided to pursue their aim of obtaining a preference for the North through precisely the opposite strategy — by seeking inflated divisions from North-South freight traffic to offset claimed Northern *disadvantages*.

During the period following the affirmance of the Commission's order in the *Class Rates* case and prior to the issuance of the orders of the Commission which are the subject of this litigation, revenues from North-South freight traffic were divided on an equal-factor basis — that is, both the Northern and the Southern railroads received a share of the revenues from that traffic based directly upon the amount of service they performed in handling it. This equal-factor basis of divisions was prescribed by the Commission itself to implement the principle of uniformity announced in the *Class Rates* case. *Official-Southern Divisions*, 287 I.C.C. 497, 533, 577-578 (1953). Under this basis, each group of railroads received an identical share of the joint rate on any shipment involving an equal haul in each territory. Where one group of railroads performed more service than the other, that

group received a larger share of the revenues, but the difference in divisions was directly related to the amount of service performed.

In 1956, however, only four years after the uniform class rate structure was put into effect, the Northern railroads filed a complaint before the Interstate Commerce Commission claiming that they are entitled to *more* than an equal share of the North-South freight revenues based upon the amount of service they perform because the costs of performing rail service are higher in the North than they are in the South. They asked the Commission to prescribe a basis of divisions with inflated Northern factors which would have accorded them 35 percent more than the Southern railroads for each unit of rail service performed.

As representatives of the interests of the people of the South, the Southern Governors' Conference and the Southeastern Association of Railroad and Utilities Commissioners intervened in the proceedings before the Commission. However, our participation in these proceedings was not designed to secure any special favor for the Southern public or for the Southern railroads. Quite the contrary, we took the position that the principle of uniformity requires that all sections of the country be treated *equally* — that, except where justified by the most imperative of special circumstances, each section should support its own transportation system.

The Northern railroads' complaint seeking an inflation in their divisions on the basis of claimed higher Northern costs raised two distinct groups of issues, each aspect of which was thoroughly contested in the proceedings before the Commission. The first group of issues to which most of the evidence and argument of the Southern railroads was directed, was whether costs on North-South freight traffic are actually higher in the North, as the

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The Southern Governors' Conference and the Southeastern Association of Railroad and Utilities Commissioners, plaintiffs in the proceedings below and appellees in this Court, respectfully move that the judgment of the United States District Court for the Eastern District of Louisiana be affirmed.

QUESTIONS PRESENTED

1. Whether the district court invaded the province of the Interstate Commerce Commission in setting aside orders of the Commission prescribing inflated divisions for the Northern railroads on the ground that such orders were based upon cost conclusions that were not supported by reasoned findings and substantial evidence as required by the Administrative Procedure Act?

2. Whether the Commission acted lawfully in prescribing an inflation in the divisions of the Northern railroads on the basis of Rail Form A territorial average costs, without either findings or evidence to support the conclusion that such costs are the product of and reflect inherent territorial disadvantages from which the North suffers as compared to the South?

3. Whether the Commission can lawfully impose the burden of the higher transportation costs of one section of the country upon another section, even if such costs reflect inherent differences between the two sections, without finding that the section being subsidized cannot support its own transportation system and that the section being called upon for such subsidy can afford to provide it without undue harm to its economy?

STATEMENT

Twenty-one years ago, this Court handed down its historic decision in *New York* v. *United States*, 331 U.S. 284 (1947), upholding an order of the Interstate Commerce Commission which struck down as unlawfully discriminatory the basic railroad class rate structure that had impeded the growth of the South since before the turn of the century. Prior to that case, railroad rates had

consistently been higher in the South than in the North, and Southern shippers had been compelled to pay substantially higher charges to reach Northern markets than Northern shippers were paying to reach Southern markets, even where the distances involved were identical. The purported justification for this rate discrimination, which both the Commission and this Court rejected, was that the North has "natural advantages" over other sections of the country — such as a heavier "concentration of population" and "the preponderance of the nation's total natural resource of energy supply" — which made it "the logical location" for many industries (331 U.S. at 314). Because of these "natural advantages," it was contended that the North is entitled to lower rates than the South for the same amount and kind of rail service.

In rejecting this proffered justification for a discriminatory class rate structure, this Court acknowledged that the North did indeed enjoy certain immense advantages over other sections of the country. But it agreed with the Commission that these advantages were as much an effect of, as a cause for, the discriminatory rate structure (331 U.S. at 315):

> " . . . It is sufficient at this point to say that the record makes out a strong case for the inference that natural disadvantages alone are not responsible for the retarded development of the South and the West, that the discriminatory rate structure has also played a part. How much a part cannot be determined, for every effect is the result of many factors. But the inference of prejudice from the discriminatory rate structure is irresistible. If this discriminatory rate structure is not justified by territorial conditions, then its continued maintenance preserves not the natural advantages of one region but man-made trade barriers which have been imposed upon the country. . . ."

Northern railroads asserted, for the same amount and kind of rail service. The Southern railroads sought to show that the claim of higher Northern costs was based entirely upon *territorial average costs* that did not measure the costs of performing rail services of the same amount and kind in both territories, which, of course, is the only relevant comparison since North-South freight traffic is, by definition, the same traffic in both territories. We joined in and supported the position of the Southern railroads on this issue.

The second, and by far the most important group of issues from the standpoint of these appellees, related to the question of whether, even assuming the Northern railroads' claim of higher costs to be valid, the Commission should prescribe an inflated basis of divisions to offset such costs. Our position was that the Commission should not force the railroads, and hence, indirectly the public, of one section of the country to subsidize the transportation system of another section, without some showing of special circumstances that would justify and require shifting the burden of one section to another.

On February 3, 1965, and May 18, 1965, the Commission issued its orders in this case. The Commission did not give the Northern railroads the full 35 percent inflation which they requested; however, the orders involved here inflate the Northern railroads' divisions so that they receive, on the average, 17 percent more than the Southern railroads for the same amount and kind of service. These court proceedings were instituted to review the lawfulness of the Commission's prescription of this inflation.

The district court proceedings revolved principally about the question of whether the Commission's reports lawfully resolved the issues which had been presented to it. In granting the Northern railroads' request for an in-

flated basis of divisions, the Commission had discussed at length the contention that territorial average costs did not measure the costs of handling North-South freight traffic. But it had rejected that contention largely on the ground that there was no choice but to use territorial average costs, since no other cost data were available to it which had been prepared on a comparable basis in both territories. Moreover, the Commission had virtually ignored our contention that the North's divisions should not be inflated even if their costs of handling North-South traffic were somewhat higher than the South's. On this point, the Commission had said that "an adherence to uniformity as such, without a careful evaluation of the statutory criteria and the evidence of record" would not be proper (325 I.C.C. at 27). But the Commission had nowhere attempted to evaluate the evidence and arguments which we advanced to support a continuation of the principle of uniformity.

The district court found legal defects in the Commission's treatment of both these aspects of the case. It first pointed out that the Commission's use of territorial average costs was not supported by reasoned findings or substantial evidence as required by the Administrative Procedure Act (B. & O. J.S. App. 25a). The district court then went on to observe that the Commission had failed to follow similar statutory requirements in dealing with our contention that bare differences in cost, even if properly found to exist, should not automatically be reflected in interterritorial divisions (B.&O. J.S. App. 18a). Accordingly, the district court's opinion provides that "upon remand, the Commission should decide and dispose of this contention in accordance with the Administrative Procedure Act" (B. & O. J.S. App. 19a).

NO SUBSTANTIAL ISSUE IS PRESENTED FOR PLENARY CONSIDERATION BY THIS COURT.

The basic issue presented by these appeals is whether the district court was correct in holding that the Commission could not prescribe a basis of divisions on North-South freight traffic which would compel the South to subsidize the Northern railroads without supporting that action with reasoned findings supported by substantial evidence.

In dealing with this issue, it is important to keep in mind the fact that the action of the Commission in prescribing such an inflated basis of divisions is as novel as it is far-reaching. Indeed, the South is the only section of the country which has been called upon to support the transportation system of another section. The equal-factor divisions prescribed for application between the North and Southwest in *Official—Southwestern Divisions*, 287 I.C.C. 533 (1953), have never been challenged and are still in effect. The Commission also prescribed equal-factor divisions for application between the North and the Midwest in *Official—Western Trunk Lines Divisions*, 316 I.C.C. 351 (1962), and although the particular scale prescribed in that case was set aside as improperly constructed (*Atchison, Topeka & Santa Fe Ry. Co. v. United States*, 225 F.Supp. 584 (1965), it has since been replaced with another equal-factor scale by mutual agreement (see agreement attached to Joint Petition to Dismiss in Docket No. 34515, dated March 25, 1966), which agreement was formally approved by order of the Commission dated April 8, 1966.

The only inflated basis of interterritorial divisions now in effect other than the one at issue in this case was prescribed in the *Transcontinental Divisions* case for application between Mountain-Pacific territory and the Midwest where different rate levels are also in effect (*Akron,*

Canton & Youngstown R. Co., et al v. Atchison, Topeka & Santa Fe Ry. Co., et al., 321 I.C.C. 17 (1963)).[1] Since the inflation in the transcontinental divisions of the Mountain-Pacific railroads is specifically based upon and justified by higher rates in that territory, that inflation amounts to nothing more than an arrangement whereby the Mountain-Pacific railroads can retain the higher rates paid by the people of that territory — a fact which the Commission itself recognized and relied upon in prescribing the inflation (321 I.C.C. at 77). Hence, the South is the only section of the country being forced to subsidize the railroads of another section through inflated divisions unrelated to higher rates in effect in that section.

In setting aside the Commission's orders in this case, the district court did not reach the ultimate question of whether there are limits upon the statutory power of the Commission to force one section of the country to support another. However, the district court did quite properly take note of the fact that this would be the effect of the orders here. This Court should also keep this fact in the forefront of its consideration of this case, for the issue here is not simply whether the Commission has lawfully divided a sum of money between two groups of railroads, but, rather, whether it has made findings based upon substantial evidence, to justify orders which introduce the wholly unprecedented concept that the railroads of one section of the country should be supported by the people of another section. We submit that the correct resolution

[1] This was the order which was upheld by this Court in *Chicago & North Western Ry. Co.* v. *Atchison, Topeka & Santa Fe Ry. Co.* 387 U.S. 326 (1967). The divisions prescribed by the Commission between the North and Mountain-Pacific territory in that case, which were not brought before this Court, were based upon point-to-point percentages making it difficult to relate service performed to the divisions prescribed. However, the Northern railroads themselves have subsequently described these divisions as roughly equivalent to the equal-factor divisions in effect between the North and the South prior to the orders involved in this case.

of this issue is so clear that this case does not warrant plenary consideration.

I. THE DISTRICT COURT CORRECTLY SET ASIDE THE COMMISSION'S COST FINDINGS AS ARBITRARY AND UNSUPPORTED BY SUBSTANTIAL EVIDENCE.

The main contention of both of the Jurisdictional Statements filed in this case is that the district court somehow invaded the province of the Interstate Commerce Commission and made that agency's performance of its task more difficult by holding that the Commission had acted arbitrarily and without the support of substantial evidence in using Rail Form A territorial average costs as equivalent to the costs of handling North-South freight traffic on several critical cost issues. Neither of the appellants actually seeks to demonstrate that there was substantial evidence to support the Commission's action, and neither suggests that this Court should itself review the record to determine whether such evidence exists. Instead, they seek a holding that the Commission was entitled to do what it did without regard to what was or was not in the record. We shall show that this contention is without merit; but, before doing so, the whole issue of cost measurement must be put in perspective.

The single most important fact about Rail Form A average costs is that these average costs tend to vary directly with the degree of industrialization in the areas served by the railroads for which costs are being computed — that is, the greater the degree of industrialization in any area, the higher the Rail Form A average costs of the railroads serving that area. The reason for this correlation between Rail Form A average costs and the degree of industrialization in an area is that, with few exceptions, it costs considerably more to handle manu-

factured goods than to handle raw materials. Special equipment must be used to handle many manufactured articles — equipment which is more expensive, which usually requires greater maintenance, and which almost invariably has a much higher than average empty return ratio because it is not suitable for any return haul. Raw materials, on the other hand, usually move in the least expensive equipment in multi-carload quantities which permit a considerable saving in switching expense per car. Moreover, a high degree of industrialization in an area also often forces the railroad serving that area to perform other expensive services, such as commuter passenger service, which increase the Rail Form A average costs of railroads serving the more industrialized areas.

The railroads serving the Northeastern portion of the United States handle far more manufactured traffic than any other group of railroads in the country. The concentration of basic industry, such as iron and steel, in the Northeast is well known. But the dominance of that section of the country is even greater with respect to the manufacture of durable consumer goods, such as automobiles. Nearly all of the automobile parts used throughout the country are manufactured in the North. Hence there is a very heavy movement of this important traffic both within the North and between the North and other sections of the country in which the Southern railroads do not participate. The South, on the other hand, is a deficit area with respect to most manufactured goods, so the movement of such goods within the South without the participation of the Northern railroads is much more limited.

The result of this substantial difference in the degree of industrialization and, therefore, in the amount of manufactured traffic moving, in the North and in the South is that the Rail Form A average costs of the Northern railroads are the highest of any railroads in the coun-

try and the average costs of the railroads serving the South are the lowest. (The Western railroads, serving an area less industrialized than the Northeast but more industrialized than the South, show average rail costs precisely in line with that degree of industrialization.) The following table graphically depicts this situation: [2]

	Per Capita Value Added by Manufacture (1956)	*Rail Form A Territorial Average Costs (1956)*
Official Territory	229	122
Western Territory	118	115
Southern Territory	100	100

This table shows a clear correlation between the degree of industrialization of an area and the Rail Form A average costs of the railroads that serve it. Of course, the correlation is not a perfect one, since other factors also influence Rail Form A average costs. In the North, for example, the inflating influence of manufactured traffic is partially offset by the greater amounts of coal traffic handled by the Northern railroads, since coal is one of the cheapest commodities to handle. And in the West, the inflating influence of manufactured traffic is only one of several factors (such as the necessity for crossing mountain ranges) which contribute to the higher cost level of those railroads. However, in each case, it is clear that the degree of industrialization of any section of the country is an important factor influencing the level of the Rail Form A average costs of its railroads.

Since the level of Rail Form A average costs is influenced so greatly by the degree of industrialization of the area served, such average costs do not precisely measure either the actual costs to a single railroad of carrying a single commodity or the relative costs of two

[2] Table based upon data set forth in V.S. No. 15, Exs. 1 and 5 and costs constructed from the Commission's Statement 2-58, which was used by the Commission here (see B.&O. J.S. App. 67a). The indexes were constructed by treating Southern figures as 100 and calculating percentage deviations for the North and the West.

groups of railroads in carrying the same commodity or commodities. No commodity will have cost characteristics precisely identical to the theoretical average commodity, even in a single territory; nor will the Rail Form A averages for any two groups of railroads be based upon the same amount and kind of service in both territories. Consequently, in any case in which the critical issue is the cost of service in handling a particular commodity or the relative cost of service in handling the same commodity in two territories, Rail Form A average costs do not necessarily measure the costs of the shipments at issue.

In this case, of course, the cost issue before the Commission was the relative costs of the Northern and Southern railroads in handling North-South freight traffic — a defined body of traffic which by definition consists of the same carloads of freight in both territories. Since about one-half of this traffic originates in the industrial North, it contains a higher percentage of the more costly to handle manufactured goods which predominate in that territory than the average traffic handled by the Southern railroads. On the other hand, since roughly one-half of the North-South traffic originates in the South, it is also true that such traffic contains a higher percentage of cheaper to handle raw materials than the average traffic handled by the Northern railroads.

Notwithstanding these obvious differences between North-South traffic and territorial average traffic in the North and the South, the Northern railroads sought to rely upon the unadjusted Rail Form A averages for those two territories as measuring the costs of North-South traffic and justifying an inflation in their divisions. The Southern railroads resisted this theory and sought to show that Rail Form A average costs reflect substantial differences in the kinds of service being performed in the

two territories. Where the service in the two territories is the same, as it is on North-South traffic which is the same traffic moving in both territories, the Southern railroads contended that the costs of the Northern railroads were no higher than Southern costs. And in support of this conclusion, the Southern railroads showed a number of instances in which the higher Rail Form A averages were the product of differences in the kinds of service performed in the two territories, such as the inclusion in the averages of commuter passenger deficits, the distortion of the Northern territorial average empty return ratios caused by the heavy movement of automobile parts in the North, the distortion in their own switching costs caused by heavy intraterritorial movements of raw materials in bulk, and so on.

The district court specifically relied upon these differences between North-South freight traffic and territorial average traffic in the North and South in setting aside the Commission's orders, pointing out that under the Commission's own standard, it could not ignore these differences and rely exclusively upon averages (B.&O. J.S. App. 25a):

> "Evidence of overall territorial averages surely can and should be considered, but as to specific important cost items the Commission should not wholly and exclusively rely on such averages. *United States v. Abilene and Southern R.R. Co.* 265 U.S. 274; *Atchison, Topeka and Santa Fe Ry. Co. v. United States*, 225 F. Supp. 584. The Commission stated its exclusive standard to be the relevant cost of handling the specific freight traffic to which the divisions apply. We are persuaded that the order is not based on substantial evidence nor supported by reasoned findings within the meaning of Sections 8(b) and 10 (e) of the Administrative Procedure Act because the use of territorial averages accounting for the Northern inflation has not been supported with find-

ings of evidence relating any such inflation to the North-South freight traffic."

When the issues now sought to be presented by the appellants in this case are considered against this background, it is apparent that the Commission's action in prescribing an inflation in the divisions of the Northern railroads based exclusively upon unadjusted Rail Form A averages is vitiated by serious legal defects and that the district court was eminently correct in setting that action aside. The dispute between the Northern and the Southern railroads brought directly into issue the accuracy of Rail Form A averages as a measure of the relative costs of the two groups of railroads in handling North-South traffic. Hence, the Commission had a plain duty to resolve that issue; but this was a duty which the Commission completely failed to perform. After making some minor adjustments in the Rail Form A averages, the Commission proceeded to reject each and every one of the Southern railroads' principal cost adjustments, not on the basis of any evidence that Rail Form A did accurately measure the relative costs with respect to the particular factor involved, but largely because no other data were available showing costs on a comparable basis in both territories,[3] or because the Southern railroads were unable to show the precise extent to which the Rail Form A averages distorted a particular cost factor.[4] The Commission thus simply *assumed* that Rail Form A averages

[3] For instances in which the evidence of the Southern railroads was rejected for a lack of "comparable" data for the North, see 325 I.C.C. at 69 (refrigerator car empty return ratios); 325 I.C.C. at 76 (switching costs); 325 I.C.C. at 60 (count of cars interchanged). See also 325 I.C.C. at 66, where the Commission reached a similar result due to an absence of "adequate" data (box car empty return ratios).

[4] The Commission relied upon this kind of consideration in rejecting the Southern railroads' adjustment of border interchange costs as an "estimate" (325 I.C.C. at 81) and insisting upon use of the territorial averages, which were 58% higher in the North, despite undisputed evidence that these averages were not applicable, simply because a precise showing of actual border interchange costs had not been made.

measure the costs of handling North-South freight traffic without making any findings on the material issues raised to challenge that assumption and without evidence to show that such averages were applicable. In setting this action aside, the district court did nothing more than it was absolutely required to do by the Administrative Procedure Act.

Section 8(b) of the Administrative Procedure Act provides that the Commission's decisions must "include a statement of (1) findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record . . ." (5 U.S.C. § 557(c)). Section 10(e) of that Act provides that Commission action shall be held unlawful and set aside where its findings are "unsupported by substantial evidence" and where found to be "arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law" (5 U.S.C. § 706). This Court has repeatedly held that these requirements are to be strictly enforced. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156 (1962); *Gilbertville Trucking Co.* v. *United States*, 371 U.S. 115, 130 (1962).

Although both appellants contend otherwise, the district court's decision enforcing these provisions of the Administrative Procedure Act will in no way impair the ability of the Commission to administer the Interstate Commerce Act. The Commission does not use, and could not rationally use, Rail Form A average costs as the automatic cost formula to resolve all of the cost issues which come before it. Quite the contrary, as appellants themselves admit (B.&O. J.S., p. 13), from the very inception of the Rail Form A cost formula, the Commission has recognized that "The ascertainment of the costs of transporting a particular commodity over a single railroad or group of roads, for instance, obviously requires more re-

finement in procedure . . .". (*Class Rate Investigation, 1939*, 262 I.C.C. 447, 693 (1945)). Hence, the Commission can and does adjust Rail Form A average costs in most of the cases in which a precise determination of cost of service is a vital issue.

Midwest Emery Freight System, Inc. v. *Baltimore & R. Co.*, 321 I.C.C. 637 (1964), is an excellent example of the typical approach of the Commission. In the *Midwest Emery* case, the Commission made numerous cost adjustments to determine the costs of the particular traffic involved in that case, including a radical adjustment in the empty return ratio (from the territorial average of 79 percent to 13.7 percent) on the basis of a special study submitted by the railroads of their actual experience in handling that traffic (321 I.C.C. at 650). In making this adjustment, the Commission specifically repudiated the claim that Rail Form A territorial averages automatically produce "reasonably accurate criteria of the ratio of the empty to the loaded movement of the cars utilized by the defendants in the instant service" (*ibid.*).

The Commission has repeatedly used the same approach in cases where the issue was the cost of handling a single commodity, including a number of divisions cases involving adjustments of the very cost factors which the Commission refused to adjust here. In *Louisville & Nashville R. Co.* v. *Southern Ry. Co.* 319 I.C.C. 639 (1963), for example, a case involving the divisions of coal rates, the Commission made a substantial adjustment of Rail Form A averages with respect to car costs. And in *Illinois Central R. Co. v. Great Northern R. Co.*, I.C.C. (decided August 7, 1967), involving divisions of calcined alumina rates, the Commission prescribed divisions based upon costs reflecting several adjustments, including an adjustment to give effect to the fact that the traffic at issue required "less than average engine minutes per car in origin and destination switching."

The only cases in which the Commission has intimated that Rail Form A average costs might constitute an acceptable measure of controverted costs are the relatively rare cases involving territory-wide rates or divisions. And even in this limited kind of case, the Commission has never gone so far as to hold that Rail Form A averages can be accepted automatically without supporting evidence showing their applicability to the traffic at issue. Hence, in virtually every one of the territory-wide cases, the Commission has made some adjustment in the averages, even while stating that because a wide and varied body of traffic was involved, it may not have had to go beyond Rail Form A averages to obtain a workable measure of the actual costs of the traffic involved. Indeed, the Commission recognized the principle that adjustments must be made in Rail Form A averages in this case, for it did make some such adjustments. Thus, with respect even to territory-wide cases, Commission counsel's contention that Rail Form A averages constitute an automatically applicable measure of the costs of particular traffic (I.C.C. J.S. p. 12, note 13) is contrary to what the Commission itself has been doing and what it did in this very case. In view of this established practice of the Commission, it is apparent that the approach now urged for territory-wide cases by Commission counsel is as unnecessary to the administration of the Interstate Commerce Act as it is unsound.[5]

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[5] Although it is true that North-South traffic has widespread origins and destinations throughout both of these territories and, consequently, uses most of the rail facilities in the two territories, it does not follow at all that the average costs of all traffic handled by the Northern and Southern railroads is equivalent to their costs in handling North-South traffic. In the first place, it is plain that some rail facilities which affect the overall territorial averages have no bearing at all upon the costs of handling North-South freight traffic; the many items which the Commission itself acknowledged as being solely related to the Northern suburban passenger deficit are a clear example of this kind of facility. More importantly, even though North-South traffic uses most of the

Certainly, there is no conceptual difference between finding the actual costs of a wide and varied body of traffic and finding the actual costs of handling a particular commodity. The Commission, therefore, plainly could have used the same cost approach here that it used in *Midwest Emery, Louisville & Nashville and Illinois Central.* Nor would this approach have placed an undue burden upon the Commission. Although this case involves a much larger volume of traffic than was involved in any of those cases, the cost issues raised here are actually no broader or more difficult. The only difference is that in those cases the Commission resolved the cost issues on the basis of the evidence of record and here it ignored the evidence and accepted unsupported averages.

All three of those cases, of course, involved a situation in which the railroads voluntarily came forward with data as to their specific costs in handling particular traffic. But this fact cannot conceivably be regarded as distinguishing the present case, for in *Interstate Commerce Commission* v. *New York, New Haven & Hartford R. Co.*, 372 U.S. 744 (1963), this Court expressly held that carriers have a duty to bring forward such information (372 U.S. at 760, note 12):

> "Of course, when such an issue is raised, each carrier should bring forward the data relating to its own costs that are required for the resolution of the issue."

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facilities in the North and the South, expensive facilities as well as cheap ones, it cannot be assumed that this use of facilities occurs in the same proportion with respect to North-South traffic that it occurs with respect to the average of all traffic. Plainly, the single most important determining factor in the territorial average costs of a group of railroads is the degree to which it must use expensive facilities, (such as special purpose box cars) or perform expensive services (such as switching cars in single-car lots), and just as plainly there need be no connection between the degree to which this need arises on average traffic and on any particular segment of traffic, regardless of how widespread the origins and destinations of that traffic may be.

Hence, it is irrelevant whether carriers volunteer specific cost data; if they do not, the Commission has ample authority to require it. And the Commission has exercised that authority on numerous occasions by requiring the parties to produce special data on the traffic involved to permit a more precise determination of costs.

In *Boston and Maine R. Co.* v. *United States*, 162 F. Supp. 289 (D. Mass. 1958), for example, the court set aside a Commission order for failure to resolve cost issues in the determination of freight car rentals where the Commission possessed ample power "to turn the matter over to its accounting staff for investigation." On appeal by other parties, the Commission declined to defend its action and advised the Supreme Court of its readiness to "proceed in accordance with the terms of the remand" (358 U.S. 68, 71 (1958)). The Commission thereupon required the submission of adequate and comparable data from all railroads (Orders in I.C.C. Docket Nos. 31358 and 33145, *Railroad Freight Car per Diem Charges*).

We recognize, of course, that the mere fact that the Commission has been following this procedure voluntarily does not necessarily mean that it can be compelled to do so. But the many cases in which the Commission has adjusted cost averages on the basis of evidence and required evidence to make specific cost findings certainly show that Commission counsel are groping when they claim that such an approach to cost issues is unworkable. Plainly it is not. There can be no real doubt, therefore, that the Commission could have adopted such an approach here, rather than let this important case be determined by averages that have no real relation to its issues.

We submit that the district court was entirely correct in holding that, under the circumstances of this case, the Commission was required to compel the submission of adequate and comparable data, for nothing less would

satisfy the long-established principle that an administrative agency has an affirmative duty to see that a record is made which is adequate to permit it to assess and determine all of the public interest issues which arise out of the proceedings before it. Cf. *Udall v. FPC*, 387 U.S. 428 (1967). Commission counsel seek to make it appear that the district court went beyond this principle and required the Commission to embark "upon an independent investigation to determine whether the parties might be overlooking or concealing some relevant evidence" (I.C.C. J.S. p. 17). However, the district court held no such thing, but, instead, made it clear that the Commission was free to decide for itself how it would discharge its responsibility "to require the development of adequate and comparable cost data" (B.&O. J.S. App. 29a).

The Commission is well aware that this process need involve no independent effort on the part of its staff. In other proceedings, where the Commission has found the record to be inadequate, it has recognized this fact. Thus, in *Increased LTL, AQ and TL Rates To, From and Between New England Territory*, I.C.C. Docket No. 34454, where the Commission did not consider the data based on the various cost studies to be probative of the cost picture for New England carriers for New England operations, the Commission issued a series of special orders requiring that the carriers produce the data which it desired. When they failed to do so, the Commission denied them the rate increase which they sought (329 I.C.C. 244 (1966)). The Commission has thus demonstrated that it has ample power to discharge its responsibility to make certain that all relevant facts are disclosed in the record upon which it is to act.

There is nothing whatever inconsistent with this view of the Commission's responsibility in dealing with the issues of relative cost of service in any of this Court's

prior decisions. Certainly, neither *New York* v. *United States,* 331 U.S. 284 (1947) nor *Chicago & North Western Ry. Co.* v. *Atchison, Topeka & Santa Fe Ry. Co.,* 387 U.S. 326 (1967), relied upon by Commission counsel (I.C.C. J.S. p. 11), supports the view that Rail Form A average costs may be used to support a finding as to the costs of any particular body of traffic without independent evidence that such averages are actually applicable.

In *New York* v. *United States,* the issue before the Commission was much broader than the costs of any particular body of traffic, since the whole basic class rate structure was involved, and the principal claim of discrimination in that case was not in the handling of a particular body of traffic that had moved but in the fact that the higher class rates in the South had *prevented* traffic from moving (331 U.S. at 307-308). Hence, the issue in that case was not the costs of a particular body of traffic but the general rail costs of the territories involved, for which Rail Form A averages are much more suitable. To be sure, the averages still should have been adjusted to rule out any distorting effect of different traffic consists in the two territories, but this Court expressly found these effects had been eliminated (331 U.S. at 317). This finding clearly distinguishes the present case from *New York* v. *United States,* for it means that in that case, the record did affirmatively show that average costs were appropriate for the purpose for which they were used.

The *Chicago & North Western* case involved a precisely similar situation, for there too the Court found and expressly relied upon independent evidence in the record supporting the applicability of the Rail Form A averages to the traffic at issue. The cost issues in *Chicago & North Western* related to the Commission's use of territorial average empty return ratios and maintenance of

way and structures expense. As to the former, this Court expressly pointed out that the "Midwestern carriers . . . had come forward with specific empty-return data" (387 U.S. at 355). As to the latter, the Court upheld the Commission's finding against an attack based upon the contention that the Commission had relied upon erroneous factual premises. The Court itself reviewed the record and necessarily found the factual premises not to be erroneous (387 U.S. at 355-356).

The approach used by this Court in reviewing the record in *New York* v. *United States* and in *Chicago & North Western* is precisely the approach used by the district court here. The Commission's action in each case has been judged on the basis of the facts in the particular record upon which it was based. This approach imposes no unusual burden upon the Commission, for it requires only that the Commission comply with the Administrative Procedure Act and support its action with reasoned findings based upon substantial evidence.[6] And the existence of this kind of judicial review vindicates, rather than impugns, the integrity of the Rail Form A cost formula, despite Commission counsel's efforts to make it appear otherwise (I.C.C. J.S. pp. 10-13), for without such review, the formula might become a weapon to subvert the very principle which it was created to serve.

[6] Commission counsel are clearly wrong when they urge that there is more fairness in cost determinations based upon Rail Form A average costs than there would be in determinations based upon special studies, simply because "Rail Form A data is readily available, and does not include the biases which special studies conducted by the contesting parties might understandably reflect" (I.C.C. J.S. p. 12). The fact is, of course, that Rail Form A itself has substantial biases against any under-industrialized section. If the Commission can use Rail Form A averages to inflate the divisions of railroads of one section of the country without any evidence that they apply to the traffic involved, the more highly industrialized sections of the country are certain to gain a substantial advantage over the South. We think that this fact alone is enough to require the Commission to decide these cases on the basis of the evidence of record.

That, of course, is precisely what would have happened here, but for the decision of the district court. The Commission's Cost Section was created and Rail Form A devised at the urging of these very appellees to destroy the myth that the North was entitled to preferential class rates. Rail Form A was properly applied in that case and accomplished that purpose. But now the Commission would permit the formula to destroy the very good which it made possible by accepting an uncritical application of the averages produced by the formula to a situation in which such averages have no factual basis. Rail Form A was never intended to have such application.

II. THE COMMISSION COMMITTED REPEATED VIOLATIONS OF THE ADMINISTRATIVE PROCEDURE ACT IN DEALING WITH THE QUESTION OF WHETHER THE CLAIMED HIGHER NORTHERN RAIL COSTS ARE THE PRODUCT OF INHERENT TERRITORIAL DISADVANTAGES.

Since the cost of handling North-South freight traffic was not properly shown to be any higher in the North than in the South, the district court was clearly correct in setting aside the inflation prescribed in the Northern railroads' divisions on the sole basis of such unsupported cost conclusions. However, the correctness of the district court's judgment does not depend upon this aspect of its opinion. For even if the costs of the Northern railroads had been shown to be somewhat higher than those of the Southern railroads, neither the evidence of record nor any findings in the Commission's report support the Commission's action in prescribing divisions based upon such higher costs.

If it is assumed that the Northern railroads actually do experience higher costs for like service in handling North-South freight traffic, there are at least three pos-

sible reasons that might explain these higher costs. They are:

(1) That for reasons of greater efficiency, the Southern railroads are able to perform rail service cheaper than the Northern railroads under substantially identical conditions in the two territories;

(2) That differences in economic conditions in the two territories, specifically higher wage and tax levels unrelated to any difference in levels of productivity in the North, make costs higher in the North even though the two groups of railroads are equally efficient, and even though all other conditions affecting transportation costs in the two territories are substantially identical; and,

(3) That there are inherent differences in transportation conditions in the two territories that make the costs of rail service higher in the North without regard to the relative efficiency of the two groups of railroads, or to the economic conditions prevailing in either territory at any particular moment.

Throughout the proceedings before the Interstate Commerce Commission, these appellees have taken the position that the only cost differences that should be reflected in interterritorial divisions are those in the third category above—that is, cost differences related to inherent differences in transportation conditions.

Section 15(6) of the Interstate Commerce Act (49 U.S.C. §15(6)) does not authorize the Commission to prescribe divisions based upon relative cost of service without regard to the reasons underlying cost differences or the consequences of prescribing divisions based upon such differences. Although the section clearly permits the Commission to consider costs, it also specifically directs the Commission's attention "to the efficiency with which the carriers concerned are operated" and to "the im-

portance to the public of the transportation services of such carriers." Thus, in any case in which inflated divisions are sought on the basis of claimed higher costs, the plain duty of the Commission under Section 15(6) is to consider the reasons for such higher costs and the consequences to the public of basing divisions upon such costs.

We recognize, of course, that Section 15(6) does not say that the Commission may never prescribe divisions based upon costs that are inflated by inefficiency or divisions that would have an adverse impact upon the economy of one section of the country. However, the plain purpose of the section is to limit the situations in which that can be done to those involving a showing of special circumstances and to require the Commission carefully to consider and explain the consequences of such action. Here, the record contains no showing which even attempts to justify inflated divisions based upon cost differences in the first category above — that is, those growing out of differing levels of efficiency. Consequently, we contended before the Commission that it must examine any cost differences found to exist and determine whether such differences were the product of differing levels of efficiency. Similarly, we contended that, on the record in this case, the "importance to the public" criterion of Section 15(6) is inconsistent with the prescription of inflated divisions based upon cost differences in the second category above — that is, those growing out of different economic conditions in two sections of the country — since such an inflation could only perpetuate the difference in economic conditions upon which it was based. In this connection, we relied upon the decision of this Court in *New York* v. *United States*. As the Court said in that case, if a discrimination "is not justified by territorial conditions, then its continued maintenance preserves not the natural advantages of one region but man-made trade barriers which have been imposed upon the country" (331 U.S. at 315).

It is now substantially undisputed that the Commission did not lawfully dispose of the issues raised by our contention that the claimed higher Northern costs were not the product of inherent territorial disadvantages. The Commission simply assumed these issues away, saying, "other factors being equal, cost differences generally are the product of and reflect, the inherent advantages and disadvantages that go to make up the respective overall transportation conditions in the two territories" (325 I.C.C. at 27).

In setting aside the Commission's orders, the district court pointed out that this portion of the Commission's report was so vague that the parties could not even agree as to what the Commission had held. It then went on to observe (B. & O. J.S. App. 18a-19a):

> "Surely, the Commission report should be so phrased that there be no room for such a dispute as this. We have read the language carefully and we have some hesitation in saying which interpretation is correct. The question of whether a showing of inherent disadvantages is prerequisite to an increase in territorial divisions is, at least in the first instance, a question for the Commission. If, as petitioners read the report, the Commission has held that such a showing is necessary, then this Court need only consider whether in view of such a test, the requirements of reasoned findings and substantial evidence of Sections 8(b) and 10(e) of the Administrative Procedure Act have been met. If, on the other hand, as defendants contend, the Commission has made no holding on the question of inherent disadvantages, the Court must consider whether the Commission's failure to resolve the material issue raised with respect to that question can be reconciled with the express requirement of Section 8(b). We are considering not a restriction upon the statutory powers of the Commission to make divisions, but whether the Commission followed requirements of the Administrative Procedure Act. The Administrative Pro-

cedure Act requires findings on material issues of law. *N.L.R.B. v. Hearst Publications*, 322 U.S. 111 (1944). If, as plaintiffs assert, the Commission has held that a showing of inherent disadvantages is a pre-requisite to an increase in territorial divisions, then the Commission's conclusion (that higher Northern costs reflect inherent territorial disadvantages) is subject to attack because there are no findings as to what these inherent territorial disadvantages consisted of."

The district court's holding is clearly correct. The Commission had a plain duty, arising both from the issues presented to it by the parties and from the provisions of Section 15(6), to determine whether the cost differences which it found to exist were the product of inherent territorial differences between the North and the South. The Commission's perfunctory assumption that all cost differences reflect inherent territorial differences hardly satisfied that duty. Indeed, although counsel for the Commission seek to take some advantage of this assumption here (I.C.C. J.S. p.24, note 24), the district court was told, as its opinion points out (B. & O. J.S. App. 18a), "that the Commission made no finding on this question at all and were simply commenting on Interveners' contention." [7]

Moreover, as the district court found, the Commission did not make the findings necessary to support the conclusion that the North suffers from inherent disadvantages. The Commission did not find that all other factors that affect costs other than inherent territorial differences are in fact equal. Quite the contrary, it implicitly recognized that there are major inefficiencies in the Northern

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[7] Commission counsel's characterization of the district court's discussion of this issue as "quixotic" is neither accurate nor fair. The district court responded quite directly and succinctly to the issues presented in the briefs filed before it. In order to make it appear otherwise, Commission counsel have now changed their position and seek to obscure the plain representations made to the district court (Compare Brief of I.C.C. before the district court, pp. 79-80, with I.C.C. J.S., p. 24, note 24).

railroad system in the form of overcapacity that had to be and were being eliminated. And the Commission made no finding at all as to the relative economic conditions in the two territories, even though the Northern railroads pointed to such differences as the major reason for their claimed higher costs. This treatment of the question of whether the claimed higher Northern costs are the product of inherent territorial disadvantages clearly failed to satisfy the requirements of either Section 15(6) or the Administrative Procedure Act.

In the first place, the Commission's conclusion improperly ignored the undisputed evidence of record that the Northern costs of record were substantially higher than they need be, or will be in the very near future, because of overcapacity in the Northern rail system. The Northern railroads have in effect admitted that their rail system suffers from overcapacity to a greater extent than that of any other part of the country. In a series of important control and merger applications, they have repeatedly urged the Commission to allow them to effect major consolidations which would permit elimination of many duplicate facilities and produce vast savings. See, e.g., *Chesapeake & Ohio R. Co. — Control — Baltimore & Ohio R. Co.*, 317 I.C.C. 261 (1962); *Norfolk & Western Ry. Co. and New York C. & St. L. R. Co. — Merger*, 324 I.C.C. 1 (1964); *Pennsylvania R. Co. — Merger — New York Central R. Co.*, 327 I.C.C. 475 (1966); *Norfolk & Western Ry. Co. — Merger — Chesapeake & Ohio R. Co.*, I.C.C. Finance Docket No. 23832, now pending. These applications, aimed to bring about a complete realignment of the Northern railroads into two systems, have each been expressly predicated upon the view that maintenance of the existing rail system in the North would be wasteful in view of permanent changes that have rendered large parts of this system virtually useless.

The existence of substantial overcapacity in the Northern railroad system was recognized in the *Penn-Central Merger* case (*Pennsylvania R. Co.—Merger—New York Central R. Co.*, 327 I.C.C. 475 (1966)), where the Commission relied explicitly upon Northern railroad overcapacity as a ground for approving that merger (327 I.C.C. at 512):

> "The Eastern District has, at this time, an oversupply of rail facilities inasmuch as the total volume of rail traffic in the district does not adequately support the existing railroad plant regardless of how the traffic may be apportioned or diverted from one railroad to another." [8]

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[8] The examiners' Recommended Report in the *Penn-Central Merger* case was even more explicit in its recognition of the cause of the Northern railroads' problems (*Proposed Merger of Pennsylvania and New York Central Railroads*, (F.D. 21989, p. 198)):

> "We believe that one of the primary explanations for this trend [the massive decline of rail traffic in the North] lies in the changing structure and location of industry in the Eastern District and the nation as a whole or the 'industrial mix'. Historically, the Eastern District has been noted for its heavy industry, and the fact that it has supplied the nation with steel and other basic items which have previously moved by rail from Pittsburgh and other eastern industrial points to the western, northern and southern extremities of the nation. The growth of major population centers throughout the nation, however, which are able to support the necessary high fixed investment of heavy industry has caused a certain degree of 'decentralization' of industry. This, in many instances, has eliminated, or at least restricted, eastern producers from such markets and thereby curtailed the use of rail service to some undocumented extent.
>
> "Of equal and possibly of more importance, areas such as New England have lost a substantial portion of heavy industry which has been replaced to a major extent by light industrial production such as electronics and electronic components. As light industry generally requires less transportation for its output as well as lower material per employee, such manufacturing is not the best source of rail traffic."

In its decision the Commission expressly embraced these findings and made them its own, ordering this part of the Examiners' report "bound in printed form in the permanent series of Interstate Commerce Commission reports" (327 I.C.C. at 481).

In upholding the Penn-Central merger and permitting its prompt consummation, this Court also pointed to and relied upon this purpose of the merger to bring about "the rationalization and elimination of some of the dual facilities and services in various areas and in various respects." *Penn-Central and N & W Inclusion Cases*, — U.S. — (decided January 15, 1968).

Largely as a result of the elimination of overcapacity, the Commission found that effectuation of the Penn-Central merger would eventually result in savings in excess of $80 million a year (327 I.C.C. at 501). The Norfolk & Western-Nickel Plate-Wabash merger was found to produce savings of $29 million a year (324 I.C.C. at 80). The C&O - B&O control arrangement was found to produce savings of $44 million a year, with the possibility of substantial additional savings when those two roads are eventually merged (317 I.C.C. at 277). The N&W - C&O merger would produce further savings of $36 million a year, with the possibility of still further savings in the amount of $12 million a year from the inclusion of other railroads.

The record in this case was closed prior to the approval of any of these consolidations, and it does not therefore reflect the elimination either of the overcapacity that has already been achieved through mergers that have since been consummated or any of the other overcapacity currently being considered by the Commission in other Northern merger proceedings.[9] However, the record does

[9] In view of this fact, the district court was clearly correct in suggesting that, upon remand, a reopening of the record for additional evidence "might well be warranted" (B.&O. J.S. App. 32a). The court did not hold that the staleness of the record was a ground for setting aside the Commission's orders, but only that, since the case must go back anyway, the record ought to be brought up to date to reflect the significant changes that have occurred. Commission counsel's contention that this suggestion "might result in the Commission's never being able to decide such cases on the basis of sufficiently recent data" (I.C.C. J.S., p. 19, note 18) only emphasizes the unsupported extremes to which counsel have gone in an effort to substance to this appeal.

reflect the existence of overcapacity in the North, and these appellees repeatedly urged the Commission to take this overcapacity into account in determining the reasons for any higher rail costs which it might find to exist in the North.

The Commission brushed the entire problem of Northern overcapacity aside because it found that *some* overcapacity exists in the Southern rail system, and because the savings to be realized from mergers were not immediately available, saying (325 I.C.C. at 17-18):

> "It is true the savings expected from proposed mergers and consolidations are not reflected in the cost studies of record. However, the southern lines themselves have noted that mergers are now going forward in all territories, including the South. If and when such proposed mergers are ultimately approved and finally consummated in both groups the savings produced thereby will be *then* reflected in the respective unit costs" (emphasis supplied).

This reasoning totally misses the point insofar as the question of whether the claimed higher Northern rail costs are the product of inherent territorial disadvantages. The existence of overcapacity in the railroad system of the North produces higher transportation costs in that territory, and this is flatly inconsistent with the Commission's conclusion that any higher costs found to exist are automatically attributable to inherent disadvantages in transportation conditions. This is so regardless of *when* the savings possible from the elimination of such overcapacity are to be realized. The critical fact is that a vast potential for savings exists and that this potential is much greater in the North than in the South. This fact alone is sufficient to undercut any conclusion that the Northern railroads' present problems are due to inherent disadvantages.

The failure of the Commission to give effect to its

own recognition that the Northern railroads' costs are inflated by substantial overcapacity renders its actions unlawful under both the Administrative Procedure Act and Section 15(6) of the Interstate Commerce Act. This failure left the Commission's action without the support of reasoned findings based upon substantial evidence as required by the former Act and without any effective consideration of the statutory criterion of relative efficiency as specified in Section 15(6). Moreover, the Commission's arbitrary action in disregarding Northern railroad overcapacity leaves the South in a position where it must support this kind of inefficiency. The very existence of a right to inflated revenues based upon overcapacity will tend to discourage its elimination. Thus, to that extent, the South will be forced to get along with less of a railroad system than it needs in order that the North may preserve more than it can economically use. The Commission's reports contain no answer to the critical questions posed by reliance upon costs inflated by overcapacity: Why should the North, as a railroad rate territory, be entitled to maintain, partly at the expense of the South, a rail transportation system for more extensive than that which the South can afford to support for itself? Why should the South be forced to subsidize the uneconomic consequences of attempting to maintain facilities that are partly unneeded in the North? And why should the people of the entire country be deprived of the benefits that flow from a unified national economy unhampered by artificial barriers that prevent the most efficient allocation of transportation resources?

The Commission's insistence upon treating the claimed higher Northern costs as reflecting inherent territorial disadvantages without even considering these questions was clearly arbitrary. But the arbitrary character of the Commission's treatment of the question of whether the claimed higher Northern rail costs are

the product of inherent territorial disadvantages extended beyond even this patently improper refusal to give effect to its own findings with respect to overcapacity. The Commission also refused to give effect to the fact that the Northern railroads themselves attributed their claimed higher costs, not to inherent territorial disadvantages in the North, but to different economic conditions prevailing in that section of the country.

Throughout these proceedings, the Northern railroads have stressed the higher wage and tax levels in the North as the reason for their claims of higher cost of service. Indeed, the same contention is advanced in the Northern railroads' Jurisdictional Statement here (B. & O. J.S., p. 22, note 12). Assuming this to be so, how is it possible to square higher costs caused by higher wage and tax levels with the Commission's conclusion that such higher costs "are the product of and reflect" inherent territorial disadvantages?

Differences in wages and tax levels are significant in rail costs only if the higher wages and taxes in the North are not offset by correspondingly greater productivity for capital and workers in the North. The record indicates that Northern wages and taxes are offset here by the substantially greater traffic density of the Northern railroads (V.S. No. 36, Ex. 1, p. 21). But even if this is not the case, the necessary effect of the prescribed inflation in the Northern railroads divisions is to force the South to subsidize higher wages and taxes for the North. We submit that such a subsidy is clearly inconsistent with the public interest.

If there is one thing clear from this Court's decision in *New York* v. *United States*, it is that differences in wage and tax levels not related to differing levels of productivity are not to be used as a justification for imposing administrative regulations that perpetuate differences be-

tween two sections of the country. Such regulations would constitute a classic trade barrier and relegate the less prosperous sections of the country to a permanently subordinate position. The higher Northern costs claimed here cannot therefore properly be regarded as the product of the inherent territorial disadvantage under the Northern railroads' own theory as to the reason for such higher costs.

In *New York* v. *United States,* the Interstate Commerce Commission found that there were no inherent differences in rail transportation conditions in the North and South, and this Court reached the same conclusion itself on the basis of a review of the record in that case (331 U. S. at 315). In departing from this conclusion here, on the basis of a record which contains no new evidence on this subject, and where no party even contended that such inherent territorial differences exist, the Commission has clearly acted arbitrarily. The district court's judgment requiring that, on remand, this matter be determined in accordance with reasoned findings based upon substantial evidence is therefore correct and should be sustained.

III. THE COMMISSION'S ACTION IN PRESCRIBING AN INFLATION IN THE NORTHERN RAILROADS' DIVISIONS VIOLATES THE ADMINISTRATIVE PROCEDURE ACT EVEN IF ITS CONCLUSION THAT THE NORTH SUFFERS FROM INHERENT TERRITORIAL DISADVANTAGES IS CORRECT.

The orders involved in this case are also unlawful under the Administrative Procedure Act on the further ground that the Commission failed to make findings which would justify the imposition of the burden of inherent Northern disadvantages upon the South, even if its conclusion that such disadvantages exist is accepted. As pointed out above, these appellees contended through-

out these proceedings that the burden of any inherent disadvantages found to exist in the North should be borne by the North, through higher Northern rates, rather than by the South, through inflated Northern divisions of uniform rates. When the Commission's examiners ignored this contention, we took specific exception to this aspect of their recommended report (Southern Governors' Exc. pp. 44-55). Thus, our Exception No. 4 took issue with the examiners' recommendation of an inflation for the Northern railroads on the ground that, as recommended by the examiners, "such an inflation would amount to an imposition of a part of the Northern transportation burden upon the Southern public without any finding that the North is incapable of supporting its own transportation system" (Southern Governors' Exc. pp. 44-45). Despite this specific exception, the Commission adopted the same tactic used by its examiners and simply ignored both our exception and the basic problem to which it was directed. *There is not a single word in the Commission's report which was directed to, or in any way responds to, our exception.*

The failure of the Commission to consider or even to attempt to explain why the North should not be compelled to support its own transportation system is an especially important legal defect in its orders here. Prior to this case, the Commission's own decisions had uniformly followed a principal of primary local responsibility, as originally announced in *New England Divisions*, 126 I.C.C. 579, 599 (1927). There the Commission said:

> "The dangers in (the) . . . assumption that deficiencies in local earnings must inevitably be made up on interchange business at the expense of connecting lines are obvious. Communities and the roads which serve them might too readily arrive at the conclusion that they are 'unable' to increase local rates and, in disregard of the principle of self-help, unduly rely upon others to carry this burden."

On the basis of this principle of primary local responsibility and the numerous cases which followed and applied it, we asked the Commission to adhere to the same principle here, or at least to explain to us why it could not do so. When the Commission did neither, but simply ignored the whole matter, it effectively attempted to change its whole approach to divisions cases without any explanation at all. The district court was plainly correct in holding that this was improper under this Court's decision in *Secretary of Agriculture* v. *United States*, 347 U.S. 645 (1949). As the court below pointed out (B. & O. J.S. App. 27a):

> ". . . for many years prior to this case the Commission has consistently followed the view that the primary responsibility for meeting the cost and revenue needs of the railroads of any territory lies with the people and the industry of that territory. *New England Divisions*, 126 I.C.C. 579, 599 (1927); *Divisions of Rates, Official and Southern Territories*, 234 I.C.C. 175, 190 (1939); *Official-Southern Divisions*, 287 I.C.C. 497, 523 (1953); *Akron, Canton & Youngstown R. Co.* v. *Atchison, T. & S.F. Ry. Co.*, 321 I.C.C. 17, 51 (1963). In this very case, prior to re-opening, the Commission held that the primary division of revenues accruing from this traffic were to be made on an equal-factor scale. We recognize that the Commission is not perpetually bound by their 1953 holding, but we do believe that the Commission has special responsibilities in a case of this magnitude when it departs from its prior finding (*Sec'y of Agriculture* v. *United States*, 347 U.S. 645."

This holding of the district court is clearly correct. Section 8(b) of the Administrative Procedure Act plainly condemns the action of the Commission in at least two separate respects. First, Section 8(b) requires that the Commission rule upon each exception presented to it:

> "Prior to each recommended, initial, or tentative decision, or decision upon agency review of the decision of subordinate officers the parties shall be

> afforded a reasonable opportunity to submit for the consideration of the officers participating in such decisions . . . (2) exceptions to the decisions or recommended decisions of subordinate officers or to tentative agency decisions. . . . *The record shall show the ruling upon each such . . . exception presented.*" (Emphasis supplied) (5 U.S.C. §1007(b))

The Commission was thus under a plain duty to make a ruling upon our Exception No. 4 and this it failed to do.[10] Secondly, Section 8(b) requires that the Commission support its action with reasoned findings. There is nothing which faintly resembles such findings in the reports here.

Furthermore, the Commission's action cannot stand under Section 10(e) of the Administrative Procedure Act, for there is absolutely no evidence in the record in this case to support the Commission's decision to compel the South to subsidize the rail transportation system of the North. Instead, the record in this case affirmatively shows that the South is in no position to assume a part of the burden of supporting the Northern railroads. The Commission's preoccupation with "Economic Trends" reflected in percentage of growth (325 I.C.C. at 12-16) seems to have closed its eyes completely to the fact that the South is still by far the poorest section of the entire country, measured by almost any economic indicator that one might choose, and that the North is by far the richest. Indeed, despite the phenomenal growth that has occurred in the South since the removal of the discriminatory class rates, our position relative to that of the North has changed very little.

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[10] The view expressed by the courts is buttressed by the statement made by Representative Walter, as sponsor of the bill, when he explained the Administrative Procedure Act to the House of Representatives:

> "The record must show the official rulings of the agency upon each such finding, conclusion, or exception presented . . ." (92 Cong. Rec. 5653 (1946)).

The situation as it existed under the old class rate structure was summarized by this Court in its opinion in *New York* v. *United States* (331 U.S. at 310-313). There the Court first pointed out that as of 1939, "the great advance in the industrialization of Official Territory over the other territories need not be labored, for it is obvious," an observation the Court supported with the following data (331 U.S. at 310):

Territory	*Land Area 1940*	*Gainful Workers 1930*	*Value of Manufactured Products 1939*	*Value added by Manufacture, 1939*
Official	13.5	51.1	67.8	71.4
Southern	13.3	16.8	10.0	9.4
Western Trunk Line	20.9	13.5	9.9	8.7
Southwestern	14.2	9.3	4.5	3.3
Mountain Pacific	38.1	9.3	7.8	7.2
Total	100.0	100.0	100.0	100.0

The Court went on to show, again by a table setting forth the significant data, that the situation as of 1939 was no temporary phenomenon and, indeed, was getting worse when measured in absolute terms (331 U.S. at 311):

	Actual increase in total gainful workers 1910 to 1930	*Actual increase in value of products in all industries from 1909 to 1939*	*Actual increase in value added by manufacture in all manufacturing industries from 1909 to 1939*
Official	6,230,273	$23,561,190,000	$11,284,350,000
Southern	652,755	4,229,396,000	1,662,336,000
Western Trunk Line	904,986	3,117,079,000	1,284,798,000
Southwestern	1,011,151	1,942,378,000	580,388,000
Mountain-Pacific	1,863,419	3,320,930,000	1,341,785,000

The Court also discussed the significance of economic trends within the country in the following terms (331-313):

"The value added by manufacture in all industries from 1849 to 1939 is shown for all territories by the chart on the following page.

"From this chart it is apparent that Official Territory has maintained its commanding lead in spite of recent marked increases elsewhere, especially in the South. Similarly, for the period 1929 to 1939 the number of wage earners in manufacturing industries in the entire country decreased 11 per cent; in official territory, 12 per cent; while in the South there was an increase of 5 per cent. For the same period, values of manufactured products increased 1 per cent in the South, while they decreased 21 per cent for the entire country and 25 per cent in Official Territory. From 1930 to 1940, the number of gainfully occupied workers in manufacturing in Official Territory decreased from 70.5 per cent to 69.4 per cent of the nation's total, while in the South there was an increase from 10 per cent to 11.9 per cent. A number of manufacturing activities have increased more rapidly in the South than in Official Territory, though the reverse has been true in other industries. But in spite of the growth in industrial activities in the South and West (which appellants stress heavily), the percentage comparisons are not particularly revealing because of the great disparity between the bases on which they are computed.

"The fact remains that economic development in the South and West has lagged and still lags behind Official Territory. In 1940 the average annual dollar income per person employed in Official Territory was $1,988; in Southern $940; in Southwestern $1,177; in Western Trunk-Line $1,411. Official has 69 per cent of all workers engaged in manufacturing in the United States and 29 per cent of all workers in extractive industries. It has, for example, a high concentration in the manufacture of

steel and copper products, though less than 4 per cent of the iron ore reserves, and no reserves of metallic copper. The South and West furnish raw materials to Official and buy finished products back. They are also dependent to a great extent on the markets for their products in Official which has over 48 per cent of the population of the country, 76 per cent of the national market for industrial machinery and raw materials, 64 per cent for all goods and sources (sic), 62 per cent for consumer luxuries, and 53 per cent for consumer necessities."

The changes in this situation shown in this record do not even begin to bring about an equalization between the North and the South of the conditions described above. The 849 per cent increases shown in "Value Added by Manufacture" in the South between the year 1935 and 1956 (V.S. No. 15, Ex. No. 5) actually gives the South only 11.7 per cent of the "Value Added by Manufacture" in the country as a whole. This can be compared to the 9.4 per cent recited by the Court for the South in 1939 and the 71.4 per cent figure recited for North in the same year. The per capita statistics set out in the record (V.S. No. 15, Ex. No. 11) are to the same effect. In every category shown, the South still lags far behind the rest of the country in wealth as well as in its level of economic activity.

The Commission's orders in this case would effectively nullify the gains realized by the South as a result of the establishment of the principle of uniformity in *New York v. United States*. Although the orders here operate *directly* only upon the revenues of the railroads and not upon rates, an inflation in the Northern railroads' divisions on North-South freight traffic will inevitably have an impact not merely upon the Southern railroads' revenues but also upon the transportation system and, consequently the whole economy of the South. Because the earnings of the Southern railroads have consistently been

found by the Commission to be inadequate,[11] any action which would further reduce those rates of return for the benefit of the Northern railroads would necessarily result either in a diminution of rail services in the South, or in an increase in the rates which Southern shippers must pay for such services, or both.

It is obvious that the Southern railroads cannot spend money for maintenance and expansion of their services unless they have the money to spend. Consequently, if the Southern railroads have no excess revenues to spend for this purpose in their current earnings, a substantial decrease in those earnings would inevitably have an impact upon the railroads' operations.

The only alternative to a substantial diminution in the quality of rail service available to the people of the South would be a substantial increase in rates. Any substantial rate increase would obviously put these shippers at an even more serious disadvantage in their efforts to compete with shippers located closer to the center of population.

The extent of this unfairness becomes even more ap-

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[11] The Commission has consistently stated in its own proceedings that the rates of return of the Southern railroads are inadequate. In *Increased Freight Rates, 1951*, 284 I.C.C. 589, 612 (1952) the Commission found rates of return of these railroads to be substandard, even though they were then substantially higher than they have been in recent years, saying:

> "Judged by any standard shown of record, the rates of return earned or prospectively to be earned by the railroads by the districts and regions specified in our former reports in this case, are substandard."

And only last year, in *Increased Freight Rates, 1967*, 329 I.C.C. 854 (1967), the Commission reiterated this finding (329 I.C.C. at 872) in holding that the Southern railroads were entitled to another general freight increase designed to generate the revenues necessary to permit them to maintain their current level of service.

parent when it is realized that the Northern railroads' primary duty is to serve the competitors of Southern industry. It is common knowledge that most of the buying power of the country is concentrated in the North and that, notwithstanding the substantial geographical disadvantage which must be overcome, industries located in other parts of the country must seek to reach that market. The Commission itself recognized this situation in its report in the *Class Rates* proceeding (262 I.C.C. at 696):

> "Official territory is the greatest consuming territory in the country, and is the market that nearly all manufacturers desire to reach, particularly where they have a surplus of their products to sell. In shipping to official territory, manufacturers in the other territories not only have the disadvantage of location, but are subjected to an additional burden in those instances where they must pay class rates on a much higher level than their competitors in official territory. This situation reacts to the disadvantage of manufacturers in the other territories, and to the advantage of those in Official Territory, tends to restrict the growth and expansion of the manufacturers in the other territories, and to some extent, to prevent the establishment of new manufacturing plants in those territories."

Moreover, the alternative of a rate increase is particularly ominous here since revenues lost to the Northern railroads through their inflated divisions might be made up, in part at least, from an increase in intrastate rates within the South — rates which are of vital importance both to the growth of an independent Southern economy and in their effect upon the overall ability of Southern shippers to compete in the markets of the North. Over the protest of some of the appellees (see e.g. *King* v. *United States*, 344 U.S. 254), the Commission has successfully asserted the power under Section 13 of the

Interstate Commerce Act to take into account the entire financial condition of the railroads, rather than restricting itself to those aspects related to intrastate commerce, in passing upon the adequacy of intrastate rates.[12] Under this rule, any loss of revenues in this interterritorial divisions case may later be used by the Commission as a basis for compelling intrastate rate increases. Hence, in future Section 13 proceedings the very rates of return which the Commission has here depressed to meet the burden of claimed higher transportation costs in the North may have to be augmented by increases in intrastate rates.

The basic unfairness of imposing the burden of higher Northern transportation costs upon the South is apparent where the economy of the South is demonstrably and dramatically weaker than that of the North, as the record here unquestionably shows that of the South to be. The inevitable effect of any divisional structure that accords higher divisions to the Northern railroads would be to improve the rail transportation system of the North at the expense of the Southern public, for any transfer of divisional revenues to meet the needs of

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[12] The Commission has repeatedly utilized Section 13 orders based upon this theory as a source of additional revenues for the Southern railroads. Indeed, as a result of such proceedings or the threat of such proceedings, intrastate rate increases have been effected in each one of the States represented here during the period covered by the rate of return date set out above. See, e.g., *Louisiana Intrastate Rates and Charges*, 284 I.C.C. 467 (1952); *Alabama Intrastate Express Rates and Charges*, 288 I.C.C. 423 (1953); *Mississippi Intrastate Freight Rates and Charges*, 291 I.C.C. 39 (1953); *Louisiana Intrastate Freight Rates and Charges*, 291 I.C.C. 279 (1954); *North Carolina Intrastate Freight Rates and Charges*, 293 I.C.C. 541 (1954); *Tennessee Intrastate Freight Rates and Charges*, 294 I.C.C. 633 (1955); *South Carolina Intrastate Freight Rates and Charges*, 296 I.C.C. 159 (1955); *Alabama Intrastate Rates and Charges on Coal, Lumber, and Scrap Iron*, 297 I.C.C. 241 (1955); *Louisiana Intrastate Passenger Fares*, 305 I.C.C. 137 (1958); *Louisiana Intrastate Freight Rates and Charges*, 306 I.C.C. 301 (1959).

the Northern railroads could not fail to have an adverse impact upon rail transportation in the South, either through increased freight rates or through a diminution in the availability of rail services, facilities and equipment, or both. Consequently, a transfer of divisional revenues to the Northern railroads would bear heavily upon the Southern public regardless of the reasons that might be offered to support it.

The record shows that the Southern people are fighting a long uphill struggle in their efforts to raise their standard of living to that already enjoyed in other parts of the country. In such a situation the South cannot properly be expected to make a disproportionate contribution to the maintenance of the rail system in the North. The South has many needs of its own which must be met, and we are striving mightily to meet them despite the handicap of a still woefully inadequate industrial base. There is simply nothing whatever in the record to justify a further shackling of the efforts of our people by requiring them to subsidize the rail transportation system of the North.

The undisputed facts show no basis for the Commission's action in imposing the burden of the allegedly higher Northern transportation costs upon the Southern people. That action is therefore unlawful and should be set aside under Section 10(e) of the Administrative Procedure Act.

CONCLUSION

When the claims being pressed by the Northern railroads in this case are considered against the background of the historical context out of which they arose, it is plain that what is involved here is simply another effort to keep the South in a permanent position of economic inferiority. Whether the fashionable justification is in-

herent Northern *disadvantages,* as here, or inherent Northern *advantages,* as in the *Class Rates* case, and whether Northern rail costs are argued to be higher than those in the South or lower, the result is always the same. Thurman Arnold summed it up almost thirty years ago in a speech delivered August 22, 1941 at Hot Springs, Arkansas:

> "The industrial East has been the Mother Country. The South and West have been the colonies. The colonies have furnished the Mother Country with raw material. The Mother Country has been exploiting the colonies by selling them manufactured necessities at artificially controlled prices . . . How this all happened is a complicated process. Big business has treated the West and South primarily as a source of raw materials, not as a place to manufacture and sell finished products at competitive prices.
>
> "This is the age-old principle of colonial empires. It is dictated by the necessity of keeping up dividends in the Mother Country against cheaper local competition in the colonies. The methods of maintaining control of industrial markets in the South and West are based on the power of tightly organized cartels to control supply, transportation and distribution in such a way as to put new competing enterprise in the colonies under a continuing handicap."

In refusing to permit the Interstate Commerce Commission to promote this kind of policy without reasoned findings based upon substantial evidence as required by the Administrative Procedure Act, the district court has done nothing more than to guarantee the South the minimal protections of the law against this threat. The rightful province of the Commission has in no sense been invaded, for the Commission is still free to decide the case as it sees fit so long as it observes legal requirements.

For the foregoing reasons, the judgment of the United States District Court for the Eastern District of Louisiana should be affirmed.

Respectfully submitted,

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